******White Paper on Guaranteed Payments for Services  
Proposed Findings and Recommendations  
*Summary for Discussion Only***

The basis for these proposed findings and recommendations is set out in detail in the draft white paper, available here: <https://www.mtc.gov/wp-content/uploads/2023/04/White-Paper-on-Guaranteed-Payments-Corrected-Draft-4-19-23.pdf>, and are limited to sourcing of guaranteed payments to direct, individual partners. Payments to other partners or made through tiered or related partnerships raise other issues not addressed in the white paper.

Proposed Findings

1. Under federal tax law or guidance:
   * Guaranteed payments are distinguished from regular distributive share;
   * Payments for services are distinguished from payments for capital;
   * Payments for services performed in a foreign jurisdiction are sourced to that jurisdiction, with some limitations.
2. Under federal pension law, certain guaranteed payments to retired partners can only be sourced by their state or residence.
3. About half of the states have specifically addressed sourcing of guaranteed payments in their official guidance, including statutes, regulations, or case law.
4. The majority of those states source guaranteed payments as distributive share in all cases.
5. A minority of states source at least some guaranteed payments for services as compensation, with certain limitations.
6. Some states that provide PTE tax elections also include guaranteed payments in the PTE tax base and source them as distributive share.
7. Sourcing guaranteed payments for services as compensation requires distinguishing:
   * Guaranteed payments from special allocations (distributive share)
   * Guaranteed payments for services from guaranteed payments for capital
   * Guaranteed payments from payments to partners not acting as partners

Federal guidance needed to make these distinctions is underdeveloped and difficult to apply in practice.

1. Sourcing guaranteed payments as compensation may add administrative complexity to partnership-level reporting and withholding.
2. Disparate sourcing of guaranteed payments may result in multiple taxation, however neither the states nor taxpayers or practitioner groups have indicated that disparate sourcing of guaranteed payments causes significant problems.
3. Because guaranteed payments are simply a matter of agreement between partners, applying a different sourcing method than that used for distributive share might result in “elective” sourcing, or income shifting.

Proposed Recommendations

This white paper does not recommend a uniform method of sourcing guaranteed payments but does recommend the following:

1. States should explicitly address the sourcing of guaranteed payments in order to avoid uncertainty.
2. States should source guaranteed payments the same for individual taxation and for pass-through entity taxation.
3. States that provide guaranteed payments should be sourced as distributive share should also:
   * Address whether this applies to individuals working in foreign jurisdictions who may source the payments as compensation for federal purposes.
   * Specify that this sourcing treatment does not apply to payments made to retired partners, which are required to be sourced to residence.
4. States that source the payments as compensation should impose appropriate limits to ensure that the payments are similar to compensation for services performed and to avoid income shifting. This also means distinguishing guaranteed payments for services from guaranteed payments for capital.
5. To mitigate the possibility of multiple taxation, that states should consider provisions that might grant additional credits to residents who can show that they paid tax on more than 100% of their guaranteed payments.